

INTOUCH



with Martin Jarvie PKF

PKF

Accountants &
Business Advisers

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INTRODUCTION



This is the final InTouch newsletter of the year. The Partners and staff wish all clients and friends the very best for the festive season. We hope you have relaxing and enjoyable holidays, followed by a successful 2007.

The new year will challenge us all, as usual, with ongoing business issues. But with good planning, strategic thinking and identifying the real issues ahead, the challenges can be met. Success will follow.

As usual, we reiterate that January to March period is the ideal time to revisit business plans and personal priorities. We at Martin Jarvie PKF can help with this process.

In the meantime, our articles in this issue of In Touch cover the benefits of benchmarking, a rundown on current tax issues, the impact of the impending 4 week annual leave and internationalism along with improved accounting standards.



Graham Langridge,
Managing Partner.

BENCHMARKING – Is it for you or are you already the best you can be? by Lyn Aimers

When running your own business it is very easy to get so caught up in the everyday operations and management that you lose sight of the overall picture. Many business owners assume that, as long as their business continues to perform on a basis similar to past periods/years they shouldn't change things. The attitude that "this is the way we have always done it" may work for you now, but it may not be the best way. Sitting back on your laurels could cost you and your business dearly as competitors attack your market share.

How long is it since you have asked these basic questions:

- " How are we doing?"
- " Are we tracking the right measures?"
- " How do we compare with others?"
- " Are we using the best practices?"

These are questions that should never be far from your mind.

Benchmarking is a process used in management in which businesses evaluate various aspects of their performance and processes in relation to best practice, usually within their own industry. Having identified areas where your business is 'below par', plans can then be developed to adopt better practices with an aim of improving various aspects of performance. Benchmarking may be a one-off event, but is often considered a continuous process in which businesses continually seek to challenge their performance with a view to constant improvement.

Benchmarking can be as limited or extensive as you want it to be, but the initial step is to identify critical measures within your industry, measure your own performance and recognise where there is room for improvement.

Although benchmarking is not solely 'numbers' based, your financial data is an obvious starting point. The completion of a questionnaire addressing the other critical components of your

business is also necessary and once collated this information can be compared against industry norms. A full report can be generated for discussion and this forms the basis of identifying areas for improvement and the development of strategies to meet newly set goals. Constant monitoring of progress and dedication to the outcomes is essential in this dynamic and ongoing process. The rewards, however, are in becoming the best you can be.

In summary, benchmarking tells you how well you're really doing and creates opportunities to identify and employ new methods, ideas and tools to improve effectiveness. If you aren't already the "best" you can be we would like to work alongside you to help you on your way. We have the knowledge, tools, resources and desire to help you to help yourselves.

Do You Measure Up?.....



FOUR WEEKS ANNUAL LEAVE by Jan Polaschek

From 1 April 2007 all employees will become eligible for a minimum of four weeks annual holiday. This does not mean that on 1 April 2007 all employees currently receiving 3 weeks annual leave will immediately become entitled to an extra week. The actual date of entitlement will be determined by the individual's anniversary date so that, as each employee completes his/her current year of employment on or after 1 April 2007, their minimum holiday entitlement is adjusted to four weeks. This raises several issues and questions for employers.

Does everyone get an extra week's holiday?

Employees currently receiving 3 weeks annual leave will become entitled to a minimum of 4 weeks on the anniversary of their employment falling on or after 1 April 2007. Employers and employees can not agree to exchange the extra week for money or other benefits ("contract out") – even when this is requested by an employee.

Employees who are already entitled, under the terms of their employment agreement, to four or more weeks annual leave will not necessarily automatically receive an extra week. Their situation will depend on the exact wording of the employment agreement. Agreements providing for a specified number of weeks' annual leave (for example, specifying "four weeks annual leave") would not provide any additional entitlement. Some agreements, however, use wording about providing one or more "additional" weeks' leave than the statutory entitlement. Agreements with wording like this must be considered carefully to determine whether the additional week or weeks applies on top of the new minimum entitlement. It is advisable for employers to review employment agreements well before 1 April 2007 and if in doubt to check with an employment advisor about the effect of this change.

Employers who have choice about increasing their employees' current 4 or more weeks annual leave, will need to reflect on the issues related to this. If employees who already get four weeks annual leave (often valued employees) do not receive an increase in their leave entitlement, they are likely to feel aggrieved that they are relatively worse off than those employees who will gain an additional week's leave.

This issue is facing many New Zealand businesses and there is not an easy answer. Offering these employees five weeks leave is an additional cost and may also have an effect on productivity, role continuity and workflow management. Not offering additional leave increases the risk that these valued employees may become disgruntled. If this results in an increase in staff turnover, it can be very costly. One option may be to look at other ways to reward senior and/or long-serving staff members. Some businesses have a 'menu' of benefits, including gym memberships, subsidised childcare, health/life insurance, flexible working hours and access to unpaid leave, from which longer serving and senior staff can choose.

When should an employer start accruing holiday pay at 8%?

Employers need to accrue holiday pay at the rate of 8% of gross earnings from each employee's anniversary date on or after 1 April 2006. This must be applied to gross earnings earned from that anniversary, not just the period from 1 April 2007. Accrued holiday pay will not be paid at this rate if employment terminates prior to the employee's next anniversary date after 1 April 2007.

Employers need to budget for the increased annual holiday entitlements as a future liability so they do not face unplanned costs in the forthcoming year.

How does an employer calculate holiday pay if an employee leaves?

Careful consideration will need to be given to the calculation of holiday pay for each employee who terminates their employment over the next two years. Here are some examples of calculations, assuming the employee's anniversary day is 15 August.

- The employee leaves between 15 August 2006 and 31 March 2007.
 - Pay outstanding holidays from the entitlement the employee established on 15 August 2006 (at the greater of average or ordinary earnings).
 - Pay 6% of gross earnings from 15 August 2006 to the date of termination (less payment for any holidays taken in advance).
- The employee leaves between 1 April 2007 and 14 August 2007.
 - Pay outstanding holidays from the entitlement established on 15 August 2006
 - Pay 8% of gross earnings from 15 August 2006 to the date of termination.
- The employee leaves between 15 August 2007 and 14 August 2008.
 - Pay outstanding holidays from the entitlement established on 15 August 2007, which will have been four weeks.
 - Pay 8% of gross earnings from 15 August 2007 to the date of termination.

Paying holiday pay on an "as-you-go" basis after 1 April 2007

It is important to remember that employees may be paid holiday pay on a pay-as-you-go basis only:

- where there is a genuine fixed term agreement of less than 12 months, or
- where employees' work patterns are genuinely casual (irregular).

In either of these situations, the employee's entitlement changes on 1 April 2007 to 8% of the employee's gross earnings for each pay period.

Note: An arrangement to pay holiday on an "as-you-go" basis must be written into the employment agreement, and holiday pay must be shown separately from wages or salary.



TAX ARTICLES by Mike Ruffell

Market salaries and tax avoidance

Case W33 has raised a number of questions over the last year or two about which business structures are acceptable to the IRD and what exactly is tax avoidance. To recap, case W33 concerned a dentist who restructured the ownership of his practice – for sound business reasons - and saved quite a lot of tax in the process. This irked the IRD who obligingly took the dentist to court, claiming tax avoidance on the basis that the dentist had been paid an artificially low salary.

In the past few months, there has been a lot of concern that the IRD would challenge taxpayers who operate via companies or trusts, where those taxpayers were not remunerated at a 'market' rate.

Our Accountancy Institute, ICANZ, sought clarification from the IRD regarding this concern, noting that there was no compulsion in the Income Tax Act to pay a market salary.

In response to this, the IRD provided a letter from its National Manager of Technical Standards. In summary, the key messages were that the IRD does not have a general power to require a salary to be paid by an employer at any specific level, particularly without regard to a business' profitability. But the IRD does have broad discretion to reconstruct income in cases of avoidance, and will take into account the particular circumstances and the way in which the relevant arrangements have been implemented in deciding what approach should be taken.

What we make of this is that:-

- Care should be taken to split the business profit from a fair remuneration for the personal efforts of the stakeholders.
- If the business makes a loss, then it is reasonable that no salary be paid in that year.
- The IRD are more likely to review the tax effect of a restructured business, rather than a structure adopted from the outset. Clearly, good business reasons for a restructure – well documented - will be a good rebuttal to many advances from the IRD.

The news in brief – its been a busy year for tax

- **Kiwisaver** – takes effect from 1 July 2007, compulsory for employers to offer and new employees will be caught, unless they opt out; employer contributions of up to 4% can be made tax free, as long as they're matched by the employee contribution; provision for Govt kickstart of \$1,000.
- **Taxation of Offshore Investments.** The Govt have dumped the proposal to tax foreign equity investments on accrued capital gains, and is now considering a 'fair dividend rate' model. This is an unpopular proposal – even within the Govt. A proposed implementation date is 1 October 2007.
- **Govt to soften penalties regime.** The Govt is looking at options for relaxing penalties when people have genuinely tried to do the right thing but failed. This includes not imposing shortfall penalties for lack of reasonable care etc if the taxpayer concerned made a voluntary disclosure before being notified of a pending tax audit, and that disclosure is within two years of filing the return.
- **Charities** – the new Charities Act is now law, and brings with it many reporting requirements for charities, most importantly, the requirement to register with the Charities Commission in order

to obtain a tax exemption. The good news is that registration will be open from 1 February 2007, and charities will have until 1 July 2008 until the new provisions take effect.

- **Business tax review** – less content than expected here. The big ticket items are proposed lower company rates; tax credits for R & D, Export Market Development and Skills Training; risk that top personal rate will be dropped, along with the trustee rate to 36%; Increased deductibility of 'blackhole' expenditure – for example, losses on sale or demolition of buildings. (And follows recent changes to allow deductions for failed patent and resource consents applications); Allowing R & D expenditure, deferred for tax purposes, to survive a change of ownership. (i.e. extension of loss carry forward rules). The intention is that the business tax changes be in place by 1 April 2008.
- **Partnership law** – The Govt has issued a discussion document on partnerships, which seeks to clarify difficult questions of what happens on entry/exit of partner; offer of limited liability (and loss) partnerships – preferred vehicle of venture capitalists; mention of upcoming review of LAQCs. New legislation expected in 2007.
- **Managed Fund Investments - PIE Rules.** The Govt has proposed 'PIE' rules (Portfolio Investment Entities) whereby investments in NZ and Australian shares by NZ residents via NZ based managed funds (unit trusts mainly) will be exempt from NZ tax on most capital gains, and any taxable income distributed to unit holders will be taxed at that individuals marginal rate (i.e. like a withholding tax) up to 33%. This approach is intended to encourage saving. The proposed implementation date is 1 October 2007.
- **Recent IRD practice** has been to target particular transactions in an industry, for example, clients who received Council/ Government grants to complete earthquake strengthening. The answer that IRD were looking for here is:-
 - The cost of the earthquake strengthening was capitalised.
 - The grant received is used to reduce the depreciation base.
 This approach by the IRD is a trend following on from the recent establishment of the Risk Analysis Unit within IRD.
- **GST – Homestays.** Over the last year or so, the IRD have increasingly been challenging the GST registration of many holiday homes, home-stays, farm-stays and serviced apartments. Client's who have claimed GST input tax credits to date on many of these investments, may be required to deregister in the near future and pay GST output tax on the deemed sale of the property at market value. As a concession, affected taxpayers will be allowed to de-register in the future, presumably without being penalised. Clients affected by this should start planning for this now.
- **Business use of cars.** Remember, 9 to 5 leases are dead, mileage reimbursement or FBT are the way forward. We can work with you to find the best option for you.
- **Alignment of GST and Provisional Tax.** The intention is to make it easier for businesses to pay their GST and provisional tax as both payments can be made at the same time – although these rules are complex. The changes will be phased in over two years, from:-
 - 1 April 2007 - due dates for GST payments and returns changes to 28th of the month.
 - 1 April 2008, taxpayers will have the option to base their provisional tax on their GST turnover, and pay the provisional tax at the same time as their GST.

INTERNATIONALISM - FRIEND OR FOE? By Robert Elms



As you may know, Martin Jarvie PKF has had a long association with PKF International. For many years this association could have been described as relatively benign, but the association is now taking on increasing relevance with the move to the adoption, by New Zealand, of international accounting and auditing standards.

Over the past couple of years, New Zealand along with 100 or so countries has moved to adopt a platform of International Financial Reporting Standards, International Auditing Standards and International Quality Control Standards. As Chartered Accountants we are obliged to comply with these standards and all company clients are obliged to comply with the International Reporting Standards from 1 January 2007.

The adoption of standards consistent throughout most of the developed world highlights the ongoing globalisation of business and provides a more even playing field for operating across country borders in the future.

What the introduction of the International Financial Reporting Standards will mean to a particular client will depend very much on the size and nature of their business or indeed their investments.

For smaller companies with business interests solely in NZ, the implications will be minor whilst for larger companies with interests across foreign borders, including Australia, the implications will be much greater.

The new standards will apply to listed companies, finance companies and the like and will on implementation affect the reported profits of the business. Whilst these companies, when first presenting their financial statements prepared under the new standards, are required to restate the comparative information, there will no doubt be some confusion and settling down period as investors understand the effects of the change in reporting.

The consistency of standards, both for deriving the numbers in the financial statements and for subsequently auditing the numbers, will however, mean that the financial statements become more understood by readers anywhere in the developed world. The consistency of standards will allow foreign regulators, bankers and investors to more easily compare the relative profitability and financial strength of similar companies based in different parts of the world.

The move in New Zealand to international standards allows Martin Jarvie PKF to more readily tap into the resources of PKF International for technical issues as well as expanding opportunities for us to refer clients confidently to PKF associates around the world.

The aspect of consistent standards throughout the world gave rise recently to a flying visit to Singapore for Robert to a PKF meeting on the requirements of the International Standards on Quality

Control that all Chartered Accounting firms are required to comply with. It was evident that the international standards required in respect to quality are increasing all the time. Much of the requirements of the quality standards have stemmed from the audit failures internationally of companies such as Enron. There is now a world wide culture of quality control being developed that should reduce the risk of such failures in the future.

The effect in New Zealand on the adoption of the international standard will affect all firms to some extent, but with most of the focus being in the audit and assurance areas. Robert confirmed that, due to our past emphasis on quality control, Martin Jarvie PKF really has only some minor documentation and operational requirements in order to comply fully with the new standards.

Our range of professional services

Business Services

- Year End Financials and Accounting
- Tax Compliance
- Financial and Management Reporting
- Profit and Cash Flow Forecasting

Business Advisory

- Strategic Business Planning
- Financial Health Analysis
- Taxation Planning and Advice
- Business and Share Valuations
- Trusts and Asset Protection
- Risk Management
- Succession Planning

Business Recovery and Insolvencies

- Business Recovery and Turnaround Management
- Business and Corporate Restructuring
- Receiverships and Liquidations

Audit and Assurance Services

- Statutory Audits
- Review Engagements
- Due Diligence
- Internal Control Reviews
- One-off Investigatory Assignments
- Scrutineering

Information Systems

- Systems Review
- Installation of Accounting Systems
- Training
- Setting Up and Documenting Procedures

Finance

- Preparation, Review and Audit of Prospectuses
- Preparation and Presentation of Finance Applications
- Financial Information Memoranda

This newsletter is for general information only and is not to be taken as a substitute for specific advice. We accept no responsibility to any person who acts on the information presented without consulting us. ©2006 Martin Jarvie PKF

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